

IT 16-0001-GIL 02/03/2016 CREDIT FOR PROPERTY TAXES

For purposes of computing the credit under IITA Section 208, property taxes paid during taxable year must be reduced by amount of property tax refunded during taxable year.

February 3, 2016

Re: Illinois property tax credit

Dear Xxxxx:

This is in response to your letter dated January 11, 2016 in which you request information related to the Illinois income tax. The nature of your letter and the information provided require that we respond with a General Information Letter (GIL). A GIL is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), which may be accessed from the Department's web site at www.tax.illinois.gov.

Your letter states as follows:

I am writing to obtain official guidance on the treatment of property tax refunds to be issued to me by COUNTY in connection with certificates of errors issued in December 2015. When I purchased my home in 2010, I was unaware of the availability of a homeowner exemption for property tax purposes, and property taxes were assessed without applying that exemption. I became aware of this exemption in late 2015 and promptly applied for certificates of error for property tax years 2011, 2012, 2013, and 2014, which the COUNTY Assessor's issued in December 28, 2015. As a result, COUNTY retroactively applied the homeowner exemption to those property tax years and will be issuing me a refund for the difference between the amount of property tax I paid for those years and the amount of adjusted property tax when taking the homeowner exemption into consideration.

Since I claimed a property tax credit on my Illinois state income tax return for property taxes paid in each year, I would like to understand the Illinois Department of Revenue's position on the effect, if any, receiving these refunds would have on my Illinois state income taxes. My legal research has not turned up anything in Illinois regulations specifically addressing how to handle refunds due to certificates of error. Below is a summary of my tax returns and the hypothetical effect of the certificate of error on my return had property taxes been properly assessed at the time.

[Table omitted]

For 2015 (2014 property tax year), I paid \$\$\$ in property taxes. The adjusted property tax amount after the certificate of error is \$\$\$\$. Based on the amount I paid in property taxes during 2015, I would be entitled to a \$\$\$ property tax credit on my 2015 return (assuming the credit is still 5% for 2015 and has not been reduced 3.75% for 2015 on the new Schedule ICR). Based on the adjusted property tax amount accounting for my refund to be received in 2016, my property tax credit would be \$\$ lower.

I can envision four potential ways to treat the certificates of error for Illinois income tax purposes:

Option #1: The refund has no effect on Illinois income taxes since, under Schedule ICR and Publication 108, you are entitled to any amount of property taxes paid in a year, and there is nothing to indicate refunds must be taken into consideration.

Option #2: Net the refund amount received in 2016 against the property taxes paid in 2016 (for the 2015 property tax year) and claim only the net amount of property taxes paid in 2016 on my 2016 Schedule ICR. This takes into account the reduction in property taxes for prior years by reducing my credit for 2016.

Option #3: Treat the property tax refunds as other additional income on Schedule M for the 2016 tax return, similar to how state tax refunds are recognized as income on the following year's federal tax returns for itemizing filers.

Option #4: File amended tax returns for 2012, 2013, and 2014, and limit the property taxes claimed on Schedule ICR to the reduced amount after considering the certificate of error.

I propose Option #2 as the most legally supportable and practical solution. Schedule ICR and Publication 108 both cite to property taxes *paid* in a given year as the relevant amount for the property tax credit, and thus provide for a cash basis tax treatment rather than focus on the amount of property taxes that should have been assessed for that year. A cash basis treatment is consistent with the fact that property taxes are claimed a year in arrears based on when they are paid (e.g. taxes paid in 2012 for 2011 property tax year are credited on the 2012 return), and the fact that under Publication 108 back taxes paid can be claimed in the year they are paid. Under this approach, since I did pay the additional property tax in past years, under Schedule ICR I was entitled to a higher credit in those years based on those higher payments. It is intuitive that the tax effect of the property tax refunds would line up with when they are received, and it is pragmatic as well, as basing the property tax credit on yearly cash flows alleviates the need for filing amended returns or extensions of return due dates due to changing circumstances or uncertainty surrounding the amount of property tax owed for a year (from litigation, property tax appeals, etc.). Option #3 would likewise be a pragmatic and equitable solution.

Option #4 would create additional work and burden of filing three amended returns for what amounts to less than \$\$\$ of taxes for each of my returns. This option also appears to contradict the cash basis treatment provided for by Schedule ICR and Publication 108. A cash basis approach is consistent with tax treatment in other contexts, such as counting the state tax refund as income the following year on

federal tax returns rather than requiring an amended return every time a refund is received. If the Department were to adopt this position, the effect would be that every Illinois income tax filer that receives a certificate of error from their county would be required to amend their prior tax return(s) and potentially pay interest and penalty. This is much more cumbersome than the forward-looking approach in Options #2 and #3. If the Department takes this position, I at least request relief from penalty and interest on the amounts owed, as I filed my returns in good faith based on the actual amounts of property tax paid at the time, and I did not receive a windfall from the time value of money since I actually did pay the higher amounts of property taxes in those years.

RULING

Section 208 of the Illinois Income Tax Act ("IITA" 35 ILCS 5/208) provides the following credit:

Beginning with tax years ending on or after December 31, 1991, every individual taxpayer shall be entitled to a tax credit equal to 5% of real property taxes paid by such taxpayer during the taxable year on the principal residence of the taxpayer. In the case of multi-unit or multi-use structures and farm dwellings, the taxes on the taxpayer's principal residence shall be that portion of the total taxes which is attributable to such principal residence.

Department Regulations Section 100.2180, which provides rules in respect of the credit under IITA Section 208, states, in part, as follows:

b) A taxpayer will qualify for the property tax credit if:

- 1) the taxpayer's principal residence during the year preceding the tax year at issue was in Illinois, and
- 2) the taxpayer owned the residence, and
- 3) the property tax billed in the tax year at issue has been paid. This is the amount paid after factoring in any applicable exemptions.

c) The credit may be based on the entire property tax bill if:

- 1) the taxpayer lived in the same residence during all of the year preceding the tax year at issue, and
- 2) the tax bill included property used only for the taxpayer's personal residence, yard, garage, or other structure used for personal purposes. If the property tax bill included not only taxpayer's personal residence, but also business, rental, or farm property, that credit may be calculated only on that portion of the property tax bill that is for the personal residence. The credit may not be taken for a vacation home.

Pursuant to these provisions, the amount of the property tax credit is based on the amount of Illinois property taxes actually paid by the taxpayer during the taxable year with respect to the taxpayer's principal residence. The fact that, in a subsequent taxable year, the taxpayer receives a refund of Illinois property taxes paid in a prior taxable year pursuant to a certificate of error, does not require the prior year's credit under Section 208 to be redetermined. The credit for the prior year is properly computed based on the amount of property tax actually paid during such year. Therefore, you should not file an amended return for any of your prior taxable years in order to reduce the amount of the credit allowed under IITA Section 208.

In addition, neither Section 208 nor any other provision of the IITA requires the recapture of a property tax credit properly claimed for a taxable year where, in a subsequent taxable year, the taxpayer receives a refund of such property taxes pursuant to a certificate of error. Compare IITA Sections 201(e)(7), 201(f)(6), 201(h)(6), 211(5), 220(d); 26 U.S.C. 111(b). Therefore, you are not required to increase the amount of income tax due for the taxable year in which the refund is received for any amount of property tax credit allowed in the prior taxable year.

IITA Section 208, set forth above, provides a credit equal to 5% of real property taxes "paid by such taxpayer during the taxable year on the principal residence of the taxpayer." For purposes of this provision, the amount considered paid during any taxable year should be reduced by any amount of property tax refunded during the taxable year for property taxes previously paid in error. Thus, where a taxpayer receives a refund of property taxes paid during prior taxable years pursuant to a certificate of error, the amount of such refund reduces the amount of property tax paid during the taxable year for purposes of computing the property tax credit for the taxable year in which the refund occurs. In your case, in determining the amount of property taxes paid during your 2016 taxable year for purposes of computing your property tax credit for 2016, you should reduce the amount paid by the amount of any property tax refund received in 2016.

As stated above, this is a GIL. A GIL does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you have further questions regarding this GIL, please call (217) 782-2844. If you have additional questions regarding Illinois income tax laws, please visit the Department's website at www.tax.illinois.gov.

Sincerely,

Brian L. Stocker
Associate Counsel (Income Tax)